Feedback on SMA

This proposed switch to Standardized Measurement Approach (SMA) may create more meaningful operational risk analytics, including scenario analysis of top risks; scenario analysis based on external loss events; loss forecasting; and greater reliance in analytics on qualitative inputs such as audit scores, metrics and Control Risk Self-Assessment (CRSA) results.

The new framework does simplify in a great way the calculation of operational risk capital and enhances comparability amongst banks.

Moreover, it's my considered view that the greater focus on analytics will enhance the soundness of the control environment, including evaluation of control tests for control failures associated with large losses and near misses.

The new SMA has to parts, so to speak:

1. The Business Indicator (BI)- a Simple financial statement proxy of Ops. risk exposure; and
2. Loss Component that captures Bank specific Operational Loss Data.

The idea behind the inclusion of (2), is twofold;

1. To enhance the SMAs Risk sensitivity; and
2. To improve operational risk management amongst Banks.

Customize internal losses calculations for Banks in the developing world

The final Operational Risk weighted assets (ORWAs) is supposed to be the sum of BI and the loss component. However, the criterion for a bank to use internal losses is that it MUST have assets above €20 BILLION. While this is reasonable for the larger banks, it might not be reflect a true picture of Operational Risk in Smaller banks. As an example, consider the top six banks in Kenya; the structure of these banks balance sheets are almost identical (by size and composition). This means they can all return the same magnitude of BI component (ILDC+SC+FC). However, the different banks may have different levels of internal losses as may be dictated by the strength of their internal controls, processes and governance.

As an improvement, I suggest that **the internal loss component be customized for smaller banks** (especially those operating in the developing world) with assets < €20 billion. This will greatly reward banks with good governance and punish those with weak governance in this part of the sphere.

Regards,

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